

THE INVESTOR'S DIGEST INTERVIEW

Fund manager banks heavily on financial-services sector

Domenic Monteferrante likes banks. In fact, he's bought a lot of them for the Canadian Equity Fund, the portfolio he runs for CIBC Global Asset Management. With their high return on investment, he says, banks offer the essential ingredient for a fund like his that's oriented for the long term



He's never seen the grassy knoll. Nor has he ever climbed to the sixth floor of the Texas School Book Depository.

But Domenic Monteferrante has read almost everything he can get his hands on — even sections of the Warren Commission report — concerning the events of that Friday afternoon in November 44 years ago.

That's because Mr. Monteferrante, the lead manager of CIBC's Canadian Equity Fund, is a self-confessed JFK assassination buff.

"It's the enigma, the mystery — the challenge of trying to figure it all out," he says by way of explaining his fascination for the subject.

Indeed, he likens the challenge of parsing the JFK puzzle to that of trying to understand investments.

Born and brought up in Montreal, Mr. Monteferrante, 48, holds both a B.A. and an MBA from that city's Concordia University.

You're based in Montreal. But Toronto is Canada's financial capital. Don't you feel left out of the loop?

Not at all. Montreal is still large enough to attract investment road shows, not to mention the CEOs of most major companies.

Still, some observers have noted differences in the way the investment communities in the two cities work.

Toronto types seem to be more interested in results over the short term; Montreal investors, with what will happen over the long haul. That Montreal is more value oriented may reflect all the pension money it manages. And the city's pension sector is big. For starters, there's the Caisse de depot, Quebec's own public pension-fund operator. At the end of 2005, it had \$216.1 billion in assets under management. Then, there are the large private pension managers: Standard Life, Montrusco Bolton and Jarilowsky Fraser. Yet another heavyweight is Bimcor, the investment arm of BCE. There's also Canadian National Railways. Not only is it a dominant presence in corporate Montreal, it runs a large pension fund as well.

As a native Montrealer, you're obviously at home working in Quebec's largest city.

Well, I speak French. So, I'm able to make presentations in that language. Moreover, I've spent my entire career in my hometown. After graduating from Concordia in 1981, I worked for five years at Canadian Pacific — until recently, one of Montreal's oldest and most prestigious corporate citizens. After that, came a 10-year stint at Bimcor, in effect, making me an employee of Bell Canada, another pillar of the Montreal business community.

Your fund consists almost entirely of large caps.

Which doesn't necessarily mean I dislike small caps. In fact, I'll occasionally use them to fill out the portfolio. Still, we believe that slow and steady wins the race. So we focus on good quality large companies — outfits with sound strategies that are well run. Our steady-as-she-goes approach also accounts for our low turnover. We don't buy for the short term. But we do continually monitor our holdings. And should a company's status change through over-valuation, new management or whatever, we won't hesitate to trim our position. I also have a predilection for large caps, if only because they're the sector I've come to know best.

Loblaw is one holding you've sold over the last six months. With good reason. Last June, one of my analysts told me she didn't think the grocery giant would make the next quarter. So even though Loblaw had long been one of our core holdings, we decided it was time to part company. The subsequent bad

news from Loblaw showed we did the right thing.

In picking stocks, you rely on four different analysts. Isn't this a cumbersome setup? Not at all. In fact, it helps take a load off my shoulders, since it allows me to farm out coverage. Yet, because I still have the final say on investment decisions, I can always challenge an analyst. Indeed, because I've covered the entire S&P/TSX at one time or another, I've got a good grasp of what each sector is all about.

So which industries do you know the best? Energy, for starters — primarily because it was one of the first sectors I covered when I started out at Bimcor. I'm also quite knowledgeable about banks and insurance companies. Power Corp., one of Canada's biggest financial-services firms, makes up a large chunk of our portfolio. Then, too, because of the many on-site visits I've made to outfits like Dofasco and Abitibi, I've got a good handle on what's happening in industrials.

So are on-site visits still an important part of your stock-selection process? Not as much as before. Vice-presidents and other officials are more tight-lipped — primarily because companies have become much more careful about what they say. Yet, if you keep your eyes peeled, you can always pick up things on your own. Take a visit I made a few years ago to a GTC Transcontinental printing plant in Montreal. During my discussion with company officials about operational capacity, I noticed several stockpiles of unused newsprint. And although the officials were upbeat about GTC's prospects, the piles of newsprint led me to believe just the opposite. Sure enough, it wasn't that long before GTC's sales began to slow down.

Scotiabank is one of your top holdings. Yet in retail banking, it trails both the Royal and Toronto-Dominion. But with Scotia, you get broader international exposure — particularly in South America

and the Caribbean. In Mexico, for example, Scotia, through its subsidiary, is that country's sixth-largest bank. And, unlike the shares of some of its rivals, Scotia stock represents good value. Yes, the company lacks a big retail presence in Quebec. But so do some of Canada's other big banks. Of course, Scotia, like its competitors, benefits from Canada's banking oligopoly. In fact, I've never met a big Canadian bank I didn't like. They boast high returns on investment, along with strong dividends — both of which are great for a long-term portfolio like ours. From 1996 to 2006, for instance, Canada's banks, on average, saw their dividends grow at a compound annual rate of 14 per cent. The banks' earnings are also robust. From 2002 to 2006, they averaged yearly earnings growth of 15 per cent. The bottom line? One bank may rise and another may fall. But as a group, banks will always provide solid returns.

You say that from a fund manager's view, CN makes

Because unlike many companies, it needn't continually build new infrastructure. In fact, the majority of its physical plant — in effect, its trackage — has been around for decades. So CN is able to devote most of its energies to generating cash flow. And CN's cash flow is strong. After paying out dividends and buying back shares, CN will probably end up this year with \$900 million in free cash. And when you add this to expected annual earnings growth of 12 per cent going forward, you get a stock that's steady-as-she-goes. Moreover, one glance at the map shows CN is well-positioned to benefit from the growth in freight traffic — both domestically and globally. With its trunk line down the Mississippi Valley, for example, the railway has managed to capture a large chunk of freight moving between Canada and the U.S. And with its transcontinental lines to Vancouver, CN is no stranger to the ever-increasing trade between Canada and the Pacific Rim. Indeed, rising shipments to and from Asia have forced the railway to upgrade its main line

through the Rockies. And because traffic flowing through Vancouver has now all but clogged that port, CN is promoting its alternate line to the Pacific — the one running from Jasper to Prince Rupert, B.C.

Gildan Activewear, a low-cost producer of T-shirts, soon hopes to start selling its own brand of socks and underwear.

Which should give the Quebec-based manufacturer a new channel for growth. Not that Gildan has been twiddling its thumbs. Over the last few years, it's pulled in annual earnings increases of 20 per cent. And in the future, it should be able to do the same. In the meantime, Gildan can only benefit from having the bulk of its plants in a region — the Caribbean — where labor costs are low. It also benefits from having equipment that's state of the art.

Teck is one of the world's major producers of zinc. It's also a money machine, having piled up \$5 billion in free cash. Of course, much of that reflects Teck's failure last year to get control of Inco. Still, Teck's loss is an investment gain, since it now plans to use some of its free cash to buy back close to 9.5 per cent of its stock. Meanwhile, with commodity prices likely to stay high, Teck can only benefit. Indeed, the company, as a multi-resource producer — copper, coal and gold round out its offerings — remains one of the best commodity plays around.

Nexen is a prime player in Canada's oilpatch. Indeed, it now outperforms its peers. To the tune of roughly 314 per cent. The company, after all, hopes to boost annual output by the end of 2007 by 29 per cent. By contrast, its peers will probably only average an increase of seven per cent. Moreover, far from being a flash in the pan, Nexen's higher production has been years in the making, reflecting as it does increased capital spending. In the meantime, the company continues to make money, pulling in fourth quarter earnings of \$77 million, or \$0.29 a share.

STOCKS DOMENIC MONTEFERRANTE LIKES

The Bank of Nova Scotia
(BNS-TSX; \$51.83)
Phone: 416-866-5982

Canadian National
Railway Co.
(CNR-TSX: \$53.77)
Phone: 800-319-9929

Gildan Activewear Inc.
(GIL-TSX; \$62)
Phone: 800-668-8337

Teck-Cominco Ltd.
(TCK.A-TSX; \$89.23)
Phone: 604-687-1117

Nexen Inc.
(NXY-TSX; \$68.14)
Phone: 403-699-4000